The Elephant in the Board Room

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In recent times, many corporate scandals and cases of governance misdemeanour have become part of business as usual. The recent events in Yes Bank, ICICI Bank, IL&FS, Indigo etc have been some instances which turned the spotlight on matters of governance. The Companies Act, 2013, SEBI's LODR, Kotak Committee etc. have provided the framework and guidelines to improve the governance. While improvement in governance will always remain a work in progress, one aspect that is often left out from discussions and which is difficult to control by any Act or regulations relates to the real problem of the Elephant in the Board Room!

When Directors in their anxiety to avoid any tension in the Board room either skirt an obvious problem or keep quiet instead of confronting the issue, the problem is not relating to rules but behaviour and conduct of the Directors. The obsession of wanting to somehow maintain peace in the Board room is often at the root of the problem.

The principal actors in corporates are the Promoters, Management, Institutional Directors, Independent Directors, Internal Auditors, External Auditors, Regulator, Government, Proxy Advisory firms, Business Analysts and Business Media. While all of these do not sit in the Board room, the outcomes of their actions and shortcomings do have a significant bearing on the company's affairs as each one of these has specific responsibility and accountability. Let us look into some of the less known and lesser discussed aspects of Board governance in India.

The search for independence

The core purpose of the Board is to deliver highest standards of value to stakeholders, act in crisis situation and control any tendency to violate the spirit of law/rules well in time. This is not only necessary for ensuring financial value but brand value as an ethically driven company. Dysfunctional, greedy and incompetent Boards can destroy the company itself. The Directors and more particularly Independent directors (IDs) are required to conduct themselves with impeccable work ethics , honest intentions and they need to Speak up about any deviance or even tendency to circumvent the rules. However, one is puzzled by the spate of governance failures in even marquee companies. Directors are the instrumentalities of governance and it is expected that they would operate ethically, with independence and fairness and pursue interests of investors and shareholders with honesty and openness.

How come then that many Directors including Independent Directors have become passive spectators of violation of governance norms. Consider the following:

1. A Non Executive Chairman being given powers through several resolutions of the Board to perform various executive duties, including raising bank loans.
2. A Director being paid disproportionate amount as commission for attending only one Board meeting.
3. Quantum of commission being decided by the promoter without discussing the issue in the Nomination and Remuneration Committee.
4. Promoter (without being a Director) attending Board meetings occupying central seating position and leading the discussions, undermining the role of the Chairman.
5. Promoter CEO planting himself as permanent invitee to the Audit Committee, Nomination and Remuneration Committee meetings.
6. TDS not deposited with authorities
7. Frequent Cheque return cases

There are also more serious violations than those listed above on related party transactions, hiring key managerial personnel without following due procedures under the Act and yet independent directors often have choose to keep their mouths shut and allowed promoters to run companies as their private fiefdoms. Sometimes to avoid any controversy related to any matter,Isome directors make a quiet departure for "Personal Reasons" without a word on the cause of their quitting the Board.

A study by Prime Database points out that there are hardly any resignations on account of issues relating to misgovernance. The data shows that while 297 Independent directors quit without assigning any reasons, 264 cited personal reasons. It is clear that no Director wants to be at the centre of any controversy by raising any issue. In exception to this, a few Directors have lately mentioned the reasons of their resignations from the Board which is a welcome beginning. These Directors quit the Board inspite of inviting the ire of the promoters and sacrificing their compensation.

Individuals can make a difference

An individual action by a Director can be very significant in motivating other Directors to join and question a wrong in the governance process. No promoter can ignore the collective voice of the Directors or even the voice of individual, if the individual director dares to resign and mention the reasons in his letter.Unless some individual Directors are driven by a sense of responsibility and constructively confront any wrong, it is difficult to bring about change in the governance process. It is very difficult to defend an obvious wrong, once pointed out by even one Director on the Board.

Apart from domain knowledge and expertise, equally important is the moral courage to point out a wrong and pursue change. It is, though, not easy to disturb the social dynamics of the Board which is manifested in socially desirable etiquettes, polite communication and often cosmetic smiles to keep the collective mood of the Board in good humour. To raise an issue in such atmosphere of social bonhomie requires courage to face rebuke, silent or otherwise, from the fellow Board members and the promoter. The task becomes more challenging when the Board may have well known professionals or many pliable members.

No amount of regulations can help if the board is packed with a pack of amiable 'yes men' occasionally asking some technical and accounting questions and walking away with a cheque and smile. It requires convictionto be different and stand up to challenge a wrong. It requires huge amount of guts to not confuse personal relations with professional duties and question the violations in a company Apart from competence of the Board members, it is the behavioural attitude that is a real issue. Not raising an issue at an appropriate time or letting go a serious violation is an invitation to a bigger violation in future.The effort should be towards correction and not suppression. Transparency is key to governance.

Common reasons for the herd mentality

Most Boards exhibit a herd mentality and my exploratory research covering interactions with several Directors of various companies has revealed some interesting reasons barring ofcourse some exceptions. The typical response from many, is

Why should I be a lone radical to raise issues when others keep quiet?

If I raise issues on merit, I may be unpopular and considered an obtrusive Board member losing further Board opportunities.

How do I care, it is beneficial to continue with attractive Board fee and commission

Why bother, it gives me opportunity to travel comfortably and be active post retirement

It gives me social status to be on many Boards

I should stand by my promoter friend by keeping quiet and support him as he always stood by me during my difficult times

In case of impending crisis, I can quietly quit without much ado.

Wanted vigilant, agile and gutsy Board members

If governance has to improve substantially, it is not through statutes and codes alone but by actual behaviour of the Directors in the Board room. There are some real hard issues for directors to consider and, let it be recognised, these directors are very senior professionals. They need to ask:

Why am I here? Am I here to enhance my social status by being a 'Yes man" to promoter or contribute through my experience and also learn.

Do I have the guts to raise issues and even rock the boat, if need be.

Do I act with my conscience?

While Independent Directors rue the increasing punitive action by the courts for their negligence leading to collapse of a company / major account turning non performing/ a big fraud, etc and put forward many defences to protect their interests, it is time that Board assignments are not taken one of the perks of the past high position and are taken seriously. The following points can help a Director to be more vigilant.

1. **It is a conscious choice to join a Board. Do your due diligence on the promoters, their governance record, performance of the company and the profile of other Directors, your interest and experience in the line of business and take a decision. So do not feel victimised, if by remaining silent and disengaged, you have lent yourself into a mess.**
2. **Do your home work, understand the business and seek information for better participation. Take as many Board as you can handle in terms of time and attention**
3. **Speak when necessary without any fear or anxiety. You have right to ask questions, seek clarifications, point out inconsistencies, if any**
4. **Support when you need to. Have a positive frame of mind and support all the decisions in the interest of the business.**
5. **Dissent when there are violations. Be a lone voice, if necessary**
6. **Do not stick to Board for greed of compensation when you are uncomfortable with the affairs or the politics inside the Board**
7. **It is not a part time employment post retirement giving some status but a serious business**
8. **No personal interest or hidden agenda to raise issues. They will weaken your voice in the Board room.**
9. **Act professionally under all circumstances, keeping in view the interests of stakeholders especially those of minority share holders.**
10. **Resign, if despite your objections, the wrong practices continue by clearly mentioning the reasons in your letter. Act with your conscience.**
11. **Read board notes thoroughly, come prepared and contribute.**

It is important to recognise that only individual Board members can bring out change in the present culture of the governance. As mentioned,you cannot combat these problems by any code. The situation is much similar to marriage which is hard work on both sides.

Marc Stinger and Sir Cary Cooper in their classic, Boards that Dare (Bloomsbury Business 2018) have rightly noted:

"Boards may have moral compass(are), may have ability (can), may have understanding (know) and even may have desire (want) but all these qualities becomes meaningless if board does not display courage (dare). Without daring Boards will not make difference".

Unfortunately, courage can not be injected .It works with personal determination. Lack of courage and not speaking out at the right time can never safeguard the interest of a company.. Highlighting the obvious problems in governance may be painful but it is in the interest of all stakeholders that issues of mis-governance are nipped in the bud.

The best way is that the Independent Directors understand their fiduciary responsibilities and act with alacrity and courage. In any case, improving governance is a collective responsibility and development of a healthy culture with deep sense of responsibility has to primarily come from within.

Role of Promoters and Chairman

The promoters and Chairman need to promote a culture of exploring issues, a culture of respecting a different points of view, undertake changes in an appropriate manner and ensure that they are improving the governance in real spirit. Some points for guidance

To help Directors increasingly understand and learn the competitive landscape of their business and how the industry functions

To help provide outside perspective and not merely the management perspective

To help non-engaged Directors, offer all the help to participate or persuade them to quit.

To discuss in the Board Intangibles like issues of talent, succession for critical roles, brand building, leadership development, etc.

To unequivocally pursue best ethical standards through disclosures and transparency

To invite and induct strong domain experts and matured leaders with track record who have transformed their past organisations.

To scrupulously follow the rules and regulations and avoid any temptation to short-circuit the process of governance.

To maintain the sanctity of discussions and not hijack them by incessant sermons and lectures.

To manage Board time productively

To be open and transparent and treating every member of the Board with grace and dignity

Role of the Regulators

In order to strengthen governance, following additional steps could be considered with due consideration and implications:

1. **A system be developed to create a pool of Independent Directors and the IDs can be selected only from a panel provided by the SEBI. This needs to be worked out as a scheme. The system of Promoter selecting an Independent Director is problematic and can not ensure independence..**
2. **Post retirement, top bank executives should not be allowed to be Directors on the Board of the company where the bank has been a lead in sanctioning loan facilities in the last 2/3 years.**
3. **Regulators should be prescribed at least two to three years cooling period before they are allowed to join any regulated entity unless it is a public sector company.**
4. **The Directorship to companies be limited to 4 companies to ensure focussed attention to Board and committee matters.**
5. **The reasons in the letter of resignation should be insisted upon, with some exceptions in public interest and in such cases an alternate mechanism must be available to communicate the reasons to regulators**
6. **If the reasons for resignation are not disclosed, the person concerned should be put on cooling period of two years, before he/she can take up any other Board position**

Finally,

Good governance is the backbone of a growth driven economy. In spite of many laws and a comprehensive Act, the situation is becoming messier. It is time that Directors take responsibility for their behaviour and actions (including inactions), come to the fore and build credibility of their respective companies by actively engaging and challenging high risk, unethical and short cut maneuvers of the companies. It is only through collective efforts that the process of governance can be improved.